IN THE

UNITED STATES

CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT

F. W. COLER, *Appellant,*

vs.

HENRY F. ALLEN, JOHN H. McGRAW, as Receiver, and PACIFIC NORTHWEST PACKING COMPANY (a corporation) and THE PACIFIC NORTHWEST PACKING COMPANY (a corporation), *Appellees.*

No. 713

APPEAL FROM THE CIRCUIT COURT OF THE UNITED STATES, FOR THE DISTRICT OF WASHINGTON, NORTHERN DIVISION.

REPLY BRIEF ON THE MERITS

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Appellees' brief attempts to sustain the lower court against the intervenor on three grounds. *First,* The State Supreme Court would not pronounce this mortgage void on such allegations as ours, that is to say, it has not gone so far against

corporate preferences as we say it has. *Second,* That, even if it has gone so far as we say, it has done so not as interpretation of local law, but only as a kind of local policy which the federal courts are not bound to follow. *Third,* The national bankruptcy act renders this State doctrine a thing of the past.

FIRST

If the State Supreme Court would hold this mortgage void against its own citizens as a local rule of policy or property, then the federal courts, under the rule in *Purifier Co. v. McGroarty,* would have to apply it as to citizens of other states. That is clear. Now, what would the State Supreme Court decide here? Would that court sustain a demurrer to this intervention of ours? We say emphatically, No. Appellee Allen, however, sees two distinctions of fact between the State cases and this—the corporations there had ceased to be going concerns, and, actual fraud was the basis of those decisions.

Let us examine and see. The first case was *Thompson v. Huron Lumber Co.,* 4 Wash., 600. That company *was a going concern* at the time of and after the mortgage. "The Company * * * continued its business in every respect in the same manner as it had done prior to the execution of the said mortgage," etc. (p. 601 of that case). The Huron Company was manifestly in the position of the Packing Company here, still going, but getting more and more in debt, "was merely using up its property without profit over working expenses" (p. 604 of that case).

This effectually disposes of the contention that the State courts would not hold void a preference by a corporation still going.

But, it is argued, there is another distinction between the *Huron* case and this, and for that reason the local courts would

not hold this Packing Company's preference void. The *Huron* case was based upon actual fraud and conspiracy. Was it? Let us see what the court says, at page 609, on a petition for rehearing, which complained that there was no good reason for holding that the mortgagee, the preferred bank, was acting in concert with the company.

"We view this point as immaterial. * * * It seems to be taken by counsel that we have insinuated some sort of conspiracy to hinder and delay the creditors between its officers and the bank, but it is not so."

Again, on page 601, the Court says, of the bank's remonstrance against an alleged finding of fact that it had actually consented to the Huron Company's course of action after or before the mortgage, "without reviewing the testimony it may be conceded that there is no such showing. The terms of the instrument they drew make a hindrance and delay *legally* certain."

Thus the two distinctions attempted by appellee here between the leading *Huron* case and this are utterly incorrect. Now, in all other respects the parallel is so striking as not to be avoided without positive ingenuity. The other side have appealed to their bill as proper to be considered here. Very good. The Packing Company, like the Huron, continued in business (32) after the mortgage, and applied its proceeds so far as the complaint shows, to current business rather than on the mortgage, thus constituting as in the *Huron* case, a legal, even if unintentional, "shield between the corporation and its other creditors, while it prosecuted its ordinary business for an indefinite length of time." The mortgage here was even more of a shield. Not only did the mortgagor continue in business leaving taxes and insurance unpaid (30-1), but the lien was to include future advances (20), thus completely putting the packing company's assets indefinitely in the control of this

mortgagee while he suffered it to continue business (as we allege, insolvent) and postpone debts already incurred.

It seems preposterous to argue that under the authority of the *Huron* case the State courts would not be bound to hold this mortgage void against creditors. The facts are extraordinarily similar. Now, on those facts what was the rule announced in the leading case?

"When it has reached a point where its debts are equal to or greater than its property, and it cannot pay in the ordinary course, and its business is no longer profitable, it ought to be wound up and its assets distributed." (*Huron* case, p. 603.)

That was the rule as first announced in 1892. In 1901 the same court in *Strohl v. Seattle Nat'l Bank,* 64 Pac. at 918, says:

"In the case of *Thompson v. Huron Lumber Co., supra,* the court uses this language [repeating it exactly as quoted above]. Such conditions are not shown to have existed in *this* case when the mortgage was made."

Is this not saying, in their very last utterance on this point, that, if such conditions did exist, the mortgage would be void? There can be but one answer. Now, what did we say in our intervention? (55). The Packing Company

"was [insolvent] at all times in the month of May, 1900, and at the time of the giving the mortgage to complainant Allen as set out in paragraph VI of complainant's bill of complaint. That at the time of giving this mortgage the defendant The Pacific Northwest Packing Company had reached a point where [exactly following the language of the rule in the *Huron* case]."

Coler, a judgment creditor on a debt antedating the mortgage, would never be demurred out of a Washington court on an allegation like this. The *Huron* case, exactly like this, on the facts, was like this in the method of attack also, a mort-

gage in foreclosure assailed by an intervening judgment creditor.

SECOND.

It is argued that, even if the Washington cases do amount to what we say, it is not a course of decision originating in local statute and so not obligatory upon this court. But it does rest in part upon statute. The court expressly says so (*Huron* case, 605, 610). It refers to the *Rouse* case in Ohio and notes the resemblance between the statutes. It was the same *Rouse* case that the United States Supreme Court followed in *Purifier Company v. McGroarty.* It may be conceded that our court was not proceeding upon a statute altogether, that it was in part acting upon a general theory. This we may concede, for that is just what the Federal Supreme Court conceded the Ohio court was doing, when it nevertheless felt bound by their doctrine. Observe the language of the United States Supreme Court speaking of the *Rouse* case. It

"proceeded *in part* upon a theory * * * But it also proceeded in large part, as the opinion clearly shows, upon the constitution of Ohio and the laws and policy of that State," etc.

Corporations, essentially the creatures of statute, can exercise only such powers as the courts of the state enacting those statutes hold *infra vires.* Anything more perfectly local cannot be imagined. A rule of state *policy,* too, is as binding on federal courts as one of statutory construction, when not in conflict with guaranteed principles of state and federal relations. (*Hartford F. Ins. Co. v. Chicago etc. Ry,* 175 U. S. 91.)

THIRD.

State insolvency laws, it is said, are superseded by the National Bankruptcy Act. Agreed. But does counsel contend that this State rule making preferences by insolvent cor-

porations void is an insolvency or bankruptcy act? If so, they are very fully answered in

Mayer v. Hellman, 91 U. S. 496.

There it was expressly decided that an Ohio law was "not an insolvent law in any proper sense of the term," though it provided that on an assignment for the benefit of creditors his trustees should file the original in a court and enter into a bond to the State.

"It does not compel or in terms even authorize, assignments; it assumes that such instruments were conveyances previously known and only prescribes a mode by which the trust created shall be enforced. * * * It does not discharge the insolvent from arrest or imprisonment; it leaves his after-acquired property liable to his creditors precisely as though no assignment had been made."

To the same effect are

Tompkins v. Hunter, 43 N. E. 532 (N. Y.)
Ebersole v. Adams, 10 Bush 83.

It is too plain for discussion that the Washington doctrine which we invoke proceeds upon no statute regulating insolvency or attempting any such thing. All that happens is this. When a corporation here reaches a certain degree of embarrassment, a preference by it is void. When any one seeks to enforce it a creditor may intervene. The creditors must be judgment creditors (see *Huron* case), not all creditors, and among such of that sort as come in the court will distribute. There is no discharge of the debtor or any other of the provisions of a scheme of bankruptcy.

The foregoing affords a speedy answer to this position. But there is another answer. *The national bankruptcy act is not operative until it is invoked.* If not invoked it may be waived by all.

Mayer v. Hellman, supra.

It was there held that the validity of an Ohio assignment could not be questioned if the National Act was not set in motion until after the six months in which the commission of an act of bankruptcy could be assailed. The same doctrine is maintained in

Boese v. King, 108 U. S. 379.

The Supreme Court of the State of Washington has had this question before it in

Strohl v. Superior Court, 20 Wash. 545,

in which they say,

"Creditors of such corporations should have their ordinary remedies under existing State laws until such corporation is adjudged a bankrupt under the law of Congress and by the proper tribunal. Unquestionably upon such adjudication the power of the State court to further proceed ceases."

This doctrine is directly sustained by *Chandle v. Siddle,* 10 Nat'l Bank Reg. 236.

Though a particular transfer may be an act of bankruptcy it is governed by State laws until the debtor is adjudicated a bankrupt under the national act.

In Re Romanow, 92 Fed. 510.
In Re Wright, 95 Fed. at 810.
Simonson v. Sinsheimer, 95 Fed. at 952.

Finally, it is very doubtful if the condition of the Packing Company here was within the present national bankruptcy act's definition of insolvency. Under the old act failure to pay in the ordinary course was enough, but under the present, sec. 1, subd. 15, insolvency exists only when the aggregate property, exclusive of any improperly disposed of, shall not at a fair valuation be sufficient to pay the debts. The distinction between the two requirements has been often point-

ed out. Now, it is quite plain that a corporate debtor might be insolvent only to a degree contravening local policy as to any longer continuing trade, and yet not within the federal enactment. This point also your Honors will find adverted to in the Washington case just cited of *Strohl v. Superior Court.* The allegations of Coler's intervention, by which allegations the successful demurrer has to be tested, would hardly present a case under the national law.

The conveyance here complained of to Allen was executed May 11th, 1900 (16, 55). Coler's intervention was filed December 31, 1900 (58). So far as the national act was concerned, creditors had waived it; complainant Allen, too, who should have had no reason to fear, if his preference was valid, and who could safely have sought, a district court in bankruptcy to enforce his lien and distribute equally to others the surplus. But most carefully did his bill refrain from any direct allegation of insolvency. Your Honors in the previous appeal say, as to insolvency in that bill, "we think it may be *inferred.*" Having thus steered originally wide of the bankruptcy act, complainant now invokes it against us. We think, however, that he has been fully answered on this point. He cannot avail himself of it at this late day without establishing the following extreme propositions—*first,* that the Washington policy on corporate preferences is a local bankrupt act; *second,* that, since the national act, a conveyance bad under local law can be attacked only under the federal act, if sufficient, and if it be not attacked there, it cannot be attacked at all.

Respectfully submitted,

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